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SUBJECT: Bond Passage Loosens Fiscal Straightjacket

11. SUMMARY: On August 6, the Guatemalan Congress passed a measure authorizing the issuance of Q3 billion (approximately \$375 million) in bonds to help cover the 2009 budget gap created by tax collections that are running nearly 8 percent below 2008 levels and nearly 20 percent below 2009 expectations. The measure together with a Q2.8 billion (\$350 million) World Bank budget assistance loan should help plug the budget shortfall, expected to be approximately Q7.5 billion (\$940 million) by year's end. The Guatemalan Central Bank (Banguat) recently revised downward its estimate for 2009 GDP growth from a range of 1 to 2 percent to a range of 0.4 - 1.2 percent. Falling growth explains the deterioration in tax revenues and the urgency of passing the bond issuance. Members of the Patriot Party, opponents of First Lady Sandra Torres de Colom's controversial Conditional Cash Transfer program, mounted an unsuccessful attempt to block the bond issuance. As it has in the past, the Colom Government marshaled sufficient support from other parties' congressional benches to overcome Patriot Party opposition. As posturing for the 2011 presidential elections gets underway, economic measures such as this will increasingly be subject to partisan congressional polemics. END SUMMARY.

Government Bonds to Alleviate Fiscal Pressures

12. According to data from the Superintendence of Tax Administration, tax collections declined 7.9 percent during the first half of 2009 compared to the same period of 2008 and were running nearly 20 percent below 2009 projections. To cover the tax revenue gap, which is currently estimated at Q7.5 billion (\$940 million), the government announced budget cuts and requested Congressional approval for the placement of Q3.0 billion (\$375 million) in bonds. Congress approved the issuance on August 6.

13. The right-leaning opposition Patriot Party, as well as leftist Congresswoman Nineth Montenegro of "Encounter for Guatemala," requested that Congress approve the bonds issuance only with a special provision to forbid budget transfers. They and some other opposition members were concerned that the government would transfer some of the funds to the First Lady's controversial social welfare programs, which have inadequate transparency controls. The private sector had also requested Congress approve transparency controls as part of the law. The approved law includes the requested budget "locks."

14. On August 24, the government met with investors and other market participants in anticipation of the August 25 launch of the bond issuance. An IMF mission was recently in the country to assess the fiscal situation and review tax revenue estimates for this year. Per the approved law, Q1.68 billion (\$210 million) will be allotted to the Ministry of Communications, Q500 million (\$63 million) to service public debt, Q400 (\$50 million) to the National Peace Fund, and Q200 million (\$25 million) to the National Registry of Citizens.

Central Bank Lowers Growth Estimates

15. In late July the Guatemalan Central Bank lowered its estimate of economic growth from a range of 1 to 2 percent to a range of 0.4 - 1.2 percent. The move follows a pattern over the last year of Banguat revising downward its growth projections in the wake of downward revisions by international financial institutions and

private economists. On July 15, the UN Economic Commission for Latin American and the Caribbean (ECLAC) forecasted a 2009 GDP contraction of 1 percent for Guatemala. Similarly, Standard and Poor's and Fitch Ratings respectively projected GDP contraction of 0.5 and 0.6 percent for this year. The IMF and World Bank still project GDP expansion for 2009 at 0.4 and 0.6 percent, respectively. Oscar Monterroso, Banguat's chief economist, refutes pessimistic predictions of GDP decline, citing Banguat's superior information on national accounts. (Note: Banguat's estimates of growth in previous quarters have generally lagged other institutions, but later fell in line with international estimates. End note.)

¶16. Banguat's most recent estimate is based on projections that exports will decline by 8.5 percent in 2009, imports by 16.7 percent, remittances by 9.5 percent and foreign direct investment by 9.3 percent. According to Banguat, the construction sector will be the most affected by the crisis in 2009, with a contraction of 9.1 percent compared to 2008. Though the new estimates from Banguat project that agricultural and industrial activities will have positive growth rates this year, representatives from those chambers believe the new estimates are unrealistic. Data from the Superintendence of Tax Administration show that the volume of sales of industrial products such as cement, non-alcoholic beverages and tobacco declined by 9.5 percent, 5.8 percent and 6.5 percent respectively during the first five months of 2009 in relation to the same period of 2008.

Congress Approves Law on Economic Recovery Program

¶17. On August 4, Congress also approved reforms to the law that authorizes the construction of the Northern Transversal Highway. The construction of this highway is one of the infrastructure projects included in the Economic Recovery Program. The approved reforms ratify the contract that was awarded to the only bidder (Solel & Boneh) in 2007 and also allows use of a \$203 million loan from the Central American Bank for Economic Integration (CABEI) to fund the project. The loan from CABEI was approved by Congress on August 10.

¶18. COMMENT: Congressional approval for the bonds issuance was slower than it otherwise might have been because of the increasingly charged political atmosphere. The governing UNE and the opposition Patriot Party anticipate that they will be the main two competitors in the 2011 presidential elections, and have begun posturing. Nonetheless, the opposition's concerns about inadequate transparency controls in the First Lady's social welfare programs have some merit.

¶19. A small part of the budget is funded through issuance of bonds each year and Congress approves each issuance separately. The issuance of bonds approved by Congress on August 6 will be only used to cover the budget gap in 2009. With revenues and economic growth continuing to fall, the government may face a larger fiscal deficit than currently anticipated, and therefore may need to make more drastic cuts before the end of the year.

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